

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF COUNTRY VILLAGE	)	
SEWER CO., INC. FOR A RATE ADJUSTMENT	)	CASE NO.
PURSUANT TO THE ALTERNATIVE RATE	)	92-375
FILING PROCEDURE FOR SMALL UTILITIES	)	

O R D E R

On September 2, 1992, Country Village Sewer Co., Inc. ("Country Village") filed its application for Commission approval to increase its sewer rates. Commission Staff, having performed a limited financial review of Country Village's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding the proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 15 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have 15 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, then this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 23rd day of November, 1992.

PUBLIC SERVICE COMMISSION

  
For the Commission

ATTEST:

  
Executive Director

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF COUNTRY VILLAGE )  
SEWER CO., INC. FOR A RATE ADJUSTMENT) CASE NO. 92-375  
PURSUANT TO THE ALTERNATIVE RATE )  
FILING PROCEDURE FOR SMALL UTILITIES )

STAFF REPORT

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Analyst, Chief  
Water and Sewer Revenue  
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Research Division

STAFF REPORT  
ON  
COUNTRY VILLAGE SEWER CO., INC.  
CASE NO. 92-375

A. Preface

On September 2, 1992, Country Village Sewer Company, Inc. ("Country Village") filed its application with the Kentucky Public Service Commission ("Commission") seeking approval to increase its tariffed sewer rates by 47 percent, an increase in annual operating revenues of \$12,104.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of Country Village's operations for the test period, the twelve month period ending December 31, 1991. Karen Harrod, CPA, of the Commission's Division of Rates and Tariffs conducted the review on September 21, 1992 at the office of Country Village's CPA, Mr. Kelly King, in Crestwood, Kentucky. Etta Townsend of the Commission's Research Division performed a review of Country Village's reported revenues at the offices of the Commission.

The findings of the field review have been reduced to writing in this report. Ms. Townsend is responsible for the sections related to operating revenues and rate design. The remaining sections of this report were prepared by Ms. Harrod. Based upon the findings of this report, Staff recommends that Country Village be allowed to increase its annual operating revenues by \$13,826.

Scope

The scope of the review was limited to obtaining information to determine whether test period operating revenues and expenses were

representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

During the course of the review, Country Village was advised that all proposed adjustments to test year expenses must be supported by some form of documentation and that all such adjustments must be known and measurable.

#### B. Analysis of Operating Revenues and Expenses

##### Operating Revenue

Country Village Sewer Co., Inc. reported test year revenue of \$22,948. Its application indicates that, at the time of filing, it had 127 customers. This number of customers would generate \$25,908 in revenue annually at current rates, a difference of \$2,960 over actual test-period revenue collected. An adjustment of \$2,960 was made to normalize revenues equatable to the number of customers utilizing services during the test-period. Pro forma test year normalized revenues from rates are \$25,908.

##### Operating Expenses

In its application Country Village reported operating expenses of \$34,827 for the test year. The pro-forma adjustments to test period expenses are discussed in the following sections of this report.

##### Owner/Management Fee

For the test year Country Village reported owner/management fees expense of \$5,975. An adjustment was proposed to include this management fee at a level of \$6,600 based on the current contract in effect with F & W Operations. According to this contract, F & W

Operations provides the labor and supervision for the normal operation and maintenance of Country Village for a fee of \$550 per month. Staff is of the opinion that this is reasonable and that an adjustment should be made to increase test-year expense by \$625, to a level of \$6,600.

#### Secretarial Salary

Country Village did not incur any expense for bookkeeping or secretarial services performed during the test year. However, documentation was provided listing the secretarial duties and responsibilities being performed by Ms. Betty Wethington. Staff also reviewed documentation indicating that Country Village intended to pay Ms. Wethington \$100 a month for these services. However, the funds would not be available until the proposed rate increase is approved.

Staff is of the opinion that the proposed secretarial salary meets the rate-making criteria of being known and measurable and should be allowed for rate-making purposes.

#### Sludge Hauling

Country Village incurred sludge hauling expense of \$7,717. Based on the invoices reviewed by Staff, the actual expense incurred by Country Village is for 2 loads each month at \$283 per load or \$566 per month. Accordingly, Staff has made an adjustment to decrease test year expense by \$925 to reflect a proforma level of sludge hauling expense of \$6,792.<sup>1</sup>

#### Chemicals

During the test year Country Village incurred chemicals expense of

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<sup>1</sup>      $\$566 \times 12 \text{ months} = \underline{\$6,792}$

\$4,557. An adjustment was proposed to decrease this amount by \$831 to eliminate expenses that were incurred in 1990 but paid during the test year. Staff has included this adjustment in the calculation of Country Village's revenue requirement.

Country Village also proposed an adjustment to increase chemical expense by \$1,765 to allow for additional chemicals that would be required as a result of a new chlorinating system being installed. According to Country Village's CPA, Mr. King, the chlorinator is in operation as of the date of this report. However, sufficient documentation was not provided to support the increased chemical expense expected to be incurred. Therefore, Staff has disallowed this adjustment for rate-making purposes.

#### Lab Fees

Country Village reported lab fees expense of \$2,340 for the test year. An adjustment was proposed to reduce this amount to \$2,160 to reflect the annualized level of expense. Country Village incurs monthly lab fees expense of \$180 which results in an annual expense of \$2,160. Accordingly, Staff has made an adjustment to decrease test year expense by \$180.<sup>2</sup>

#### Treatment & Disposal - Supplies

For the test year Country Village reported treatment & disposal supplies expense of \$1,092. An adjustment was proposed by Country Village and included by Staff to decrease this amount by \$853 to

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<sup>2</sup>	Test Year Expense	\$2,340
	Recommended Expense	2,160
	Recommended Decrease	<u>\$ 180</u>

eliminate expenses paid during the test year but actually incurred during 1990. Accordingly, treatment & disposal supplies expense has been included at a level of \$239 for rate-making purposes.

Routine Maintenance

Country Village reported routine maintenance expense of \$836 for the test year. An adjustment was proposed to decrease this amount by \$320 to exclude expenses incurred prior to 1991. Staff is of the opinion that this adjustment should be included in the calculation of Country Village's revenue requirement and accordingly has reduced routine maintenance expense to a level of \$516.

An additional adjustment was proposed to increase test year expense by \$2,073 to reflect a test year level of \$2,589. This increase was proposed as a result of increased routine maintenance expenses of \$2,331 incurred during the first six months of 1992, subsequent to the test year. Country Village proposed to calculate the pro-forma test period expense based on 1/2 of the actual test year expense, \$258, plus expenses incurred during the first half of 1992. Staff is of the opinion that this expense will vary from year to year and the adjustment, as proposed, does not meet the rate-making criteria of being known and measurable. Accordingly, it would not be appropriate to include this increase in Country Village's adjusted operations.

Agency Collection Fee

Country Village is charged a fee of \$2.00 per bill for services provided by Oldham County Water District to collect its revenues. However, this expense is not reflected in Country Village's test year

operations. The fee is included in the rate charged to the sewer customers and therefore, should be included in the determination of that rate. An adjustment was proposed by Country Village and has been included by Staff to include test year agency collection fees expense of \$3,048.<sup>3</sup>

#### Rate Case Expense

In its application Country Village proposed to include professional services expense of \$2,800 for expenses expected to be incurred as a result of this rate filing. As of the date of this report invoices have not been provided to support this expense. Therefore, Staff has excluded this adjustment in the calculation of Country Village's adjusted test year operations.

#### Depreciation Expense

Country Village reported depreciation expense of \$6,515 in its annual report for the test year. An adjustment was proposed to include this expense at a pro-forma level of \$5,799, based on depreciation schedules for current assets and capital acquisitions proposed in this application.

Based on Staff's review of Country Village's depreciation schedule, the existing plant in service will be fully depreciated as of the end of 1992. Accordingly, any related depreciation expense should be excluded from adjusted test year operations.

In its application Country Village proposed to include depreciation expense on capital improvements that are needed to operate the plant

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<sup>3</sup> 127 bills x \$2.00 x 12 months = \$3,048



efficiently and effectively. Documentation was provided to support the cost of these improvements. After consulting with the Commission engineers, Staff has calculated the related depreciation expense to be \$4,618.<sup>4</sup>

Based on the aforementioned discussion, Staff recommends that test-year depreciation expense be included at a level of \$4,618, resulting in a decrease to test year expense of \$1,897.<sup>5</sup>

Taxes other than Income Tax

Country Village reported taxes other than income tax expense of \$853 for the test year. An adjustment was proposed to include the amortization of the utility's KPDES permit that was paid in January 1992 at a cost of \$1,360 and is renewable every five years. Staff recommends this expense be included for rate-making purposes and therefore has included an increase to test year expense of \$272.<sup>6</sup>

Interest Expense

For the test year Country Village reported interest expense of \$2,456. This included interest on accounts payable to F & W Operations and interest paid to Robert Jones for the purchase of the utility in the

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<u>Description</u>	<u>Cost</u>	<u>Est. Life</u>	<u>Annual Expense</u>
Driveway & Rock	\$13,000	5 yrs.	\$2,600
Sewer Lines Reworked	18,820	40 yrs.	470
Aeration Tank Blowers	7,740	5 yrs.	1,548
			<u>\$4,618</u>

<sup>5</sup>	Test Year Expense	\$6,515
	Recommended Expense	4,618
	Recommended Decrease	<u>\$1,897</u>

<sup>6</sup> \$1,360 + 5 yrs. = \$272

amounts of \$1,013 and \$1,443, respectively.

Based on Staff's review the interest paid to F & W Operations was related to unpaid operating expenses incurred in prior years. Accordingly, the inclusion of this interest expense in Country Village's revenue requirement would constitute retroactive rate-making. The interest expense related to the debt for the purchase of the utility should also be excluded for ratemaking purposes since the customers receive no direct benefit from this expense. Therefore, Staff has made an adjustment to eliminate the aforementioned interest expense from test year operations.

In its application Country Village made an adjustment to include the interest expense expected to be incurred as a result of capital expenditures proposed in this filing. Although the application indicates that the interest will be charged at a rate of approximately 9 percent per annum, sufficient documentation was not provided to determine the actual terms of the loan. Therefore, the average interest expense on this debt cannot be determined at this time and has not been included for rate-making purposes.

#### Other Adjustments

In its application Country Village proposed adjustments to increase utility expense and maintenance expense by the amounts of \$673 and \$1,870, respectively. However, to date, documentation has not been provided to support these adjustments. It is Staff's recommendation that these adjustments be excluded from the calculation of Country Village's revenue requirement.

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### Operations Summary

Based on the recommendations of Staff, Country Village's operating statement would appear as set forth in Appendix B to this report.

### C. Revenue Requirements Determination

The approach frequently used by this Commission to determine revenue requirements for small, privately owned utilities is an 88 percent operating ratio. Staff recommends the use of this approach in determining Country Village's revenue requirements.

When using the approach recommended by Staff, Country Village's revenue requirements are \$39,734.<sup>7</sup> Staff recommends that Country Village be allowed to increase its normalized operating revenue by \$13,826.<sup>8</sup>

### D. Rate Design


Under the existing rate schedule, all residential customers are paying a flat rate. Country Village did not request a change in its rate design.


Using the existing rate design, Staff has developed rates that will produce \$39,776.40, the revenue required to meet annual operating expenses. Therefore, Staff recommends that the schedule of rates in Appendix A be approved for services rendered.

<sup>7</sup>	Adjusted Operating Expenses	\$ 34,966
	Operating Ratio	+ .88
	Required Revenue	<u>\$ 39,734</u>

<sup>8</sup>	Revenue Requirement	\$ 39,734
	Less: Normalized revenues	25,908
	Required Increase in Revenues	<u>\$ 13,826</u>

E. Signatures

  
Prepared By: Karen S. Harrod, CPA  
Public Utility Financial  
Analyst, Chief  
Water and Sewer Revenue  
Requirements Branch  
Rates and Tariffs Division

  
Prepared By: Etta Townsend  
Public Utility Rate  
Analyst  
Communications, Water and  
Sewer Rate Design Branch  
Research Division

APPENDIX A  
TO STAFF REPORT CASE NO. 92-375

The Staff recommends the following rate be prescribed for customers of Country Village Sewer Co., Inc.

<u>Customer Class</u>	<u>Rates</u>
Residential	\$26.10 per month

APPENDIX B  
TO STAFF REPORT CASE NO. 92-375

Country Village Sewer Co., Inc.  
Statement of Adjusted Operations  
Test Year Ended 12/31/91

	Test Year per Annual Report	Recommended Adjustments	Test Year Adjusted
Operating Revenues	<u>\$22,948</u>	<u>\$2,960</u>	<u>\$25,908</u>
Operating Expenses			
Owner/Management Fee	5,975	625	6,600
Secretarial Salary	-0-	1,200	1,200
Sludge Hauling	7,717	(925)	6,792
Utility Expense	4,157	-0-	4,157
Chemicals	4,557	(831)	3,726
Lab Fees	2,340	(180)	2,160
Treat. & Disposal-Supplies	1,092	(853)	239
Routine Maintenance	836	(320)	516
Agency Collection Fee	-0-	3,048	3,048
Rate Case Expense	-0-	-0-	-0-
Miscellaneous	785	-0-	785
Depreciation	6,515	(1,897)	4,618
Taxes other than Inc. Tax	<u>853</u>	<u>272</u>	<u>1,125</u>
Total Operating Expense	<u>\$34,827</u>	<u>\$ 139</u>	<u>\$34,966</u>
Operating Income	(\$11,879)	\$2,821	(\$ 9,058)
Interest Expense	<u>2,456</u>	<u>(2,456)</u>	<u>-0-</u>
Net Income	<u>(\$14,335)</u>	<u>\$5,277</u>	<u>(\$ 9,058)</u>